Supreme Court, U.S.
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No. 96-106

IN THE
# Supreme Court of the United States
OCTOBER TERM, 1996

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DAVID S. HESS, MOTORCITY OF JACKSONVILLE, LTD., and MOTORCITY OF JACKSONVILLE, INC.,
*Petitioners,*

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, AS RECEIVER FOR SOUTHEAST BANK, N.A., *et al.*,
*Respondents.*

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit**

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## REPLY BRIEF OF PETITIONERS

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The Opposition cannot and does not dispute that the decision below is in open and acknowledged conflict with decisions of the D.C. and Eighth Circuits. Pet. App. 14a, 19a, 20a. Instead, the FDIC offers two purported alternative grounds for affirmance that were not relied upon by the court below. As demonstrated herein, these alternative arguments are red herrings, which do not diminish the circuit conflict or in any way detract from the need for the Court to resolve that conflict.

1. *"Retroactivity"*: The FDIC argues that under retroactivity principles, FIRREA cannot have displaced the application of federal common law to "claims (like petitioners') based on unwritten agreements that predate FIRREA." Opp. 14-15. That is, the FDIC effectively argues that *O'Melveny & Myers* v. *FDIC*, 114 S. Ct. 2048 (1994), does not apply to pre-FIRREA conduct. Opp. 18. This breathtaking truncation of *O'Melveny* is in conflict not only with *Murphy* v. *FDIC*, 61 F.3d 34 (D.C. Cir. 1995), and other circuit court decisions that have applied *O'Melveny* to pre-FIRREA conduct, but also with *O'Melveny* itself and with *City of Milwaukee* v. *Illinois*, 451 U.S. 304 (1981), a case cited *eight* times in the Petition but never referenced in the Opposition. The FDIC's argument that whether federal statutory law displaces an "evolving" *D'Oench* doctrine could be answered differently based on whether the conduct occurred the day before rather than the day after FIRREA is no more than a diversion, which the FDIC concededly invented at the last minute (Opp. 16) solely to postpone the inevitable day when this Court directs the FDIC to conform to its governing statute.

a. The government's retroactivity argument does not diminish the conflict with *Murphy* because *Murphy*, exactly like this case, concerns an unwritten agreement and a loan transaction that predated FIRREA. 61 F.3d at 35; see *Murphy* v. *FDIC*, 829 F. Supp. 3, 4, 6 n.4 (D.D.C. 1993). *Murphy* held that application of federal common law to bar claims based on such an agreement was wrong for two reasons.

First, *Langley* v. *FDIC*, 484 U.S. 86 (1987), indicated that *D'Oench* was "a dead letter" as a basis for judicially-created federal common law even before FIRREA was enacted. 61 F.3d at 36.[1] *Murphy* is correct. *Langley* referred to *D'Oench* as "the leading case in this area *prior* to enactment of § 1823(e) in 1950" and stated that *D'Oench*'s proper post-1950 use was to assist in interpreting § 1823(e). 484 U.S. at 92-93 (emphasis added). *Langley* also rejected the FDIC's argument in that case that federal law could nullify an agreement that meets "the requirements set forth in § 1823(e)." *Id.* at 95. To the contrary, *Langley* states, such an agreement "prevails . . . . *It would be rewriting the statute to hold otherwise.*" *Id.* (emphasis added). See also *Coit Independence Joint Venture* v. *FSLIC*, 489 U.S. 561, 577-78, 585 (1989) ("state law" governs borrowers' claims against receiver based on thrift's oral agreements).[2]

*Murphy* also offered a second, more fundamental basis for refusing to apply federal common law to claims based on pre-FIRREA agreements: In FIRREA, Congress gave its answer as to whether there was a federal need for the *D'Oench* doctrine. See 61 F.3d at 40. It would be a basic violation of fundamental principles limiting the role of the federal courts for those courts to conclude that

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[1] The FDIC does not dispute either that this part of *Murphy* constitutes an acknowledged conflict with the decision below (Pet. App. 24a, 28a), or that if *D'Oench* died before FIRREA, FIRREA did not revive it. *See also Adams* v. *Zimmerman*, 73 F.3d 1164, 1168-69 n.2 (1st Cir. 1996) (noting "circuit split . . . over the question of whether 1823(e) has preempted *D'Oench*," citing, *inter alia*, *Murphy* and a *pre*-FIRREA decision, *FDIC* v. *McClanahan*, 795 F.2d 512, 514 n.1 (5th Cir. 1986)).

[2] It is remarkable that the Opposition *ignores* these portions of *Langley* and *Coit*, cited in Pet. 10-11, 21, and cites instead *lower* court decisions to define the state of pre-FIRREA law. *See* Opp. 4-5. The Court has admonished the government that under "our hierarchical federal court system," this Court's precedents, not arguably conflicting lower court decisions, define the state of federal law prior to a given statute. *Rivers* v. *Roadway Express, Inc.*, 114 S. Ct. 1510, 1519 (1994).

there was "the need for a body of federal common law under the rubric of *D'Oench*" when Congress had concluded otherwise. *Id.* This is not an issue of retroactivity but of separation of powers. " '[The Court's] commitment to the separation of powers is too fundamental to continue to rely on federal common law . . . when Congress has addressed the problem.' " *Id.* (quoting *City of Milwaukee*, 451 U.S. at 314-15).

Other circuit courts are in accord that the rationale of *O'Melveny*—that federal common law cannot be used to alter the statutory answer given by Congress—applies to pre-FIRREA conduct, and that retroactivity principles are inapplicable to that issue. See, *e.g.*, *RTC* v. *Maplewood Investments*, 31 F.3d 1276, 1286-89, 1294 (4th Cir. 1994) (holding both that *O'Melveny* bars application of federal common law to 1987 transaction and that 1988 Virginia statute could not be applied to same transaction because of nonretroactivity).[3] Indeed, even the court below indicated that if FIRREA abrogated *D'Oench*, federal common law could not bar petitioners' claims. Pet. App. 21a-22a.

b. *City of Milwaukee* establishes that *Murphy* was correct to treat the statutory displacement issue as a matter of separation of powers, not retroactivity. *City of Milwaukee* also dispositively refutes the FDIC's argument that whether FIRREA displaces federal common law can be answered differently for pre-statutory conduct than for post-statutory conduct. In *City of Milwaukee*, the displacing statute, which was silent on retroactivity, was enacted *after* (1) the conduct at issue, (2) Illinois had filed suit, and (3) this Court had ruled, in *Illinois* v. *City of Milwaukee*, 406 U.S. 91 (1972), that federal common law applied to Illinois' claims. See 451 U.S. at 309-10,

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[3] *Accord FDIC* v. *Massingill*, 30 F.3d 601, 602, 604-05 (5th Cir. 1994) (*O'Melveny* bars application of federal common law to 1985 transaction); *RTC* v. *Everhart*, 37 F.3d 151, 154 (4th Cir. 1994) (loans made between 1981 and 1985); *Davidson* v. *FDIC*, 44 F.3d 246, 250-53 (5th Cir. 1995) (pre-FIRREA conduct); *RTC* v. *Artley*, 28 F.3d 1099, 1101 (11th Cir. 1994) (same).

312 n.5. The Court nonetheless held that because of separation of powers, the subsequently-enacted statute meant that "no federal common-law remedy *was* available to respondents in this case." *Id.* at 332 (emphasis added).

Most importantly, *City of Milwaukee* explains why it would be improperly disrespectful of the separation of powers for courts to apply a federal common law rule of decision for pre-statutory conduct that disagreed with the rule enacted in the statute: "Our commitment to the separation of powers is too fundamental to continue to rely on federal common law by judicially decreeing what accords with common sense and the public weal when Congress has addressed the problem." *Id.* at 315 (quotations omitted). The Court emphasized that under separation of powers, federal courts simply could not employ a view of sound public policy that contradicted the one adopted by Congress, regardless of when the underlying conduct occurred. *Id.* at 319 & n.14 ("there is no room for courts to attempt to improve on [Congress'] program with federal common law"); *id.* at 320 ("there is no basis for a federal court to impose more stringent limitations than those imposed under the regulatory regime"); *id.* at 323 ("Although a federal court may disagree with the regulatory approach . . ., such disagreement alone is no basis for the creation of federal common law.").[4] Accordingly, because the issue is one of separation of powers, not retroactivity, *City of Milwaukee* explained that even in a case involving pre-statutory conduct, the Court "start[s] with the assumption" that a later statute displaces prior federal common law (*id.* at 317 & n.9), and "evidence of a clear and manifest purpose" to displace prior federal common law "is not required." *Id.* at 317. Rather, the burden is on the *proponent* of federal com-

[4] *See also Northwest Airlines, Inc.* v. *Transport Workers*, 451 U.S. 77, 95 n.34 (1981) ("[O]nce Congress addresses a subject, even a subject previously governed by federal common law, the justification for lawmaking by the federal courts is greatly diminished. *Thereafter, the task of the federal courts is to interpret and apply statutory law, not to create common law.*") (emphasis added).

mon law to demonstrate "congressional intent to preserve" some or all of that prior federal common law. *Id.* at 327. Thus, as *City of Milwaukee* indicates, the only relevant timing issue here is that the Eleventh Circuit extended "evolving" federal common law *seven* years after Congress had spoken, thus violating the separation of powers.

c. The government also ignores both the second half of the *O'Melveny* opinion and the fact that *O'Melveny* itself involved *pre-FIRREA* conduct. The second half of *O'Melveny* proceeds by, *arguendo*, "assuming the inapplicability of FIRREA" because there, *unlike* here, the federal *receivership* predated FIRREA. 114 S. Ct. at 2054-55. *O'Melveny* then holds that policy reasons still could not supply the requisite need for a federal common-law rule of decision for *pre-FIRREA* conduct, principally because there was no conflict between state law and "a specific, concrete federal policy" identified in "FIRREA." *Id.* at 2055. "Within the federal system, at least, we have decided that the function of weighing and appraising is more appropriately for those who write the laws, rather than for those who interpret them." *Id.* at 2056 (quotations omitted).

Perhaps most important, as in *O'Melveny* and *City of Milwaukee*, granting certiorari in this case is the only way to resolve the issue of the displacement of federal common law for *both* pre-FIRREA and post-FIRREA conduct. Waiting for a case of post-FIRREA conduct, as the FDIC suggests, would not—in light of the FDIC's recently stated "nonretroactivity" position—resolve the issue for pre-FIRREA conduct. The vast majority of recent bank and thrift failures occurred *before* FIRREA; indeed, these failures were a major reason FIRREA was enacted. Not surprisingly, the great majority of pending failed bank and thrift litigation concerns pre-FIRREA conduct.[5] As this case and *Murphy* illustrate, the conflict-

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[5] For example, on November 4, 1996, this Court hears oral argument on, *inter alia*, whether "Section 212(a) of [FIRREA], 12 U.S.C. 1821(k), eliminated the right of the [FDIC], as receiver,

ing cases involving *D'Oench*'s application to pre-FIRREA conduct continue to clog the lower federal courts. That conflict needs to be resolved. See *FDIC v. Houde*, 90 F.3d 600, 605 (1st Cir. 1996) (noting "circuit split" in case of pre-FIRREA conduct).

d. Even if retroactivity were relevant to the *D'Oench* issues, the FDIC fails to address the operative provision of FIRREA and uses the wrong date. *O'Melveny* indicates that the *date of receivership* is the critical date for determining whether application of a FIRREA provision would be "retroactive" when the issue is, as here, what rights or obligations the FDIC succeeds to as receiver for the failed bank. 114 S. Ct. at 2054. Lower courts are in accord. See, *e.g.*, *FDIC* v. *Barton*, 96 F.3d 128, 133 (5th Cir. 1996) ("courts must look to the law in effect at the time of appointment" of receiver); *FDIC* v. *Regier, Carr & Monroe*, 996 F.2d 222, 225 (10th Cir. 1993).

In this case, unlike *O'Melveny*, the date of the receivership was two years *after* FIRREA. Opp. 9. The government's retroactivity argument focuses solely on 12 U.S.C. §§ 1821(d)(9)(A) and 1823(e). 12 U.S.C. § 1821(d)(2)(H), however, which the FDIC never discusses, is the successorship provision at issue in this case and it states that all post-FIRREA receivers "*shall* pay all valid obligations of the insured depository institution in accordance with the prescriptions and limitations *of this chapter*." (Emphasis added).[6] This is the clearest command imagin-

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to assert . . . federal common law claims" against officers and directors. Brief for the FDIC, *Atherton* v. *FDIC*, No. 95-928, at I. Like this case, *Atherton* involves pre-FIRREA conduct and a post-FIRREA receiver. *Id.* at 2-3. In *Atherton*, the FDIC has *not* argued nonretroactivity, but rather has argued that FIRREA affirmatively recognizes its federal common law claims. *Id.* at 23-41 (relying on 12 U.S.C. §§ 1821(d)(2)(A)(i), 1821(k), 1818(i)(2)(B), 1818(i)(2)(C), and 1818(e)). Evidently, the FDIC's test is that it knows retroactivity when it sees it.

[6] The corollary of 12 U.S.C. § 1821(d)(2)(H), which defines the FDIC's successor obligations as receiver, is 12 U.S.C. § 1821(d)(2)

able that a post-FIRREA receiver succeeds to the obligations of the failed banks unless the receiver has a *statutory* defense. Whether FIRREA's amendment to § 1823(e) and the new § 1821(d)(9)(A) are retroactive is irrelevant to the command of § 1821(d)(2)(H) that the post-FIRREA *receiver* may use only *statutory* defenses. Accordingly, if FIRREA's amendment to § 1823(e) is not retroactive, then the pre-FIRREA version of § 1823(e) remains part "*of this chapter*" for purposes of determining whether the receiver in this case may assert a statutory defense under Section 1821(d)(2)(H) to an obligation of Southeast.[7] The government has conceded that neither the pre-FIRREA nor the FIRREA version of § 1823(e) bars petitioners' claims because those claims do not "tend[] to diminish or defeat the interest of the [FDIC] in any asset." See Opp. 21 ("Section 1823(e) applies only with respect to agreements that pertain to assets.").

In any event, the issue of whether 12 U.S.C. § 1821(d)(2)(H) in FIRREA applies to this post-FIRREA receiver cannot possibly support the FDIC's argument (Opp. 18) that this Court should ignore the conflict in the circuits acknowledged by the decision below. Neither that decision, *Murphy*, nor *Divall Insured Income Fund Ltd.*

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(A)(i), which defines FDIC's successor "rights" as receiver. *See* Pet. 23-24. In *Atherton*, which also involves pre-FIRREA conduct and a post-FIRREA receiver, the FDIC has stated: "The starting point for determining the rights of the FDIC as receiver is 12 U.S.C. 1821(d)(2)(A)(i)." Brief for the FDIC, *Atherton* v. *FDIC*, No. 95-928, at 27.

[7] *Landgraf* v. *USI Film Prods.*, 114 S. Ct. 1483 (1994), emphasizes that there is no "reason to think that all the diverse provisions of the [statute] must be treated uniformly for" purposes of determining retroactivity issues. *Id.* at 1505. Thus, the fact that the application of FIRREA's revisions to §§ 1823(e) and 1821(d)(9)(A) to pre-FIRREA conduct would be retroactive because it would injure private parties (*see id.*; Opp. 16) provides no basis for treating as retroactive the application of § 1821(d)(2)(H), which protects private parties, to post-FIRREA receivers. *See supra*, notes 5-6 (in *Atherton*, a case involving pre-FIRREA conduct and a post-FIRREA receiver, FDIC relies on five provisions of FIRREA).

v. *Boatmen's First Nat'l Bank*, 69 F.3d 1398 (8th Cir. 1995), even mentions § 1821(d)(2)(H).

e. Finally, the FDIC's argument that pre-FIRREA bank and thrift statutory law was not comprehensive (Opp. 18) is irrelevant to whether FIRREA displaces federal common law for both pre- and post-FIRREA conduct. See *City of Milwaukee*, 451 U.S. at 317-19 (1972 statute displaced application of federal common law to pre-statute conduct even though earlier statute was *not* "comprehensive"). Moreover, the FDIC is wrong for two additional reasons. First, the FDIC ignores *Mobil Oil Corp.* v. *Higginbotham*, 436 U.S. 618 (1978), which holds that the federal courts may not create federal common law "to 'supplement' Congress' answer" merely because Congress had not "enacted a *comprehensive*" statute. *Id.* at 625 (emphasis added) (cited in Pet. App. 22a and Pet. 22). See also *O'Melveny*, 114 S. Ct. at 2054 (federal common law can be displaced by a particular statutory "provision" *or* a "comprehensive" statute). The petition demonstrated that § 1823(e), both before and after FIRREA, answers—indeed, "speaks directly" to—the same question as *D'Oench* (Pet. 22), and the FDIC's Opposition effectively concedes this. See Opp. 3 (In 1950, "Section 1823(e) codified the specific result reached . . . in *D'Oench*, and . . . supplemented the protection afforded the FDIC by the common-law doctrine.").

Second, this Court has held that pre-FIRREA statutory law governed banks and thrifts such as Southeast "from [their] cradle to [their] corporate grave." *Fidelity Fed. Sav. & Loan Ass'n* v. *de la Cuesta*, 458 U.S. 141, 145 (1982) (quotations omitted); *id.* at 160-62, 166-67 (describing "comprehensive" former provisions of Title 12); see also *Coit*, 489 U.S. at 568-71 (describing "complex statutory framework" that existed pre-FIRREA); *FDIC* v. *Philadelphia Gear Corp.*, 476 U.S. 426, 432 (1986) (noting "extensive legislation on banking, including the laws that gave the FDIC its existence"). FIRREA did not invent Title 12 of the U.S. Code, FIRREA only amended that already expansive Title.

2. *1821(d)(9)(A)*: The FDIC argues that 12 U.S.C. § 1821(d)(9)(A) provides a potential alternative ground for affirmance. This argument is expressly contradicted by *Langley* and every applicable circuit court decision.

a. The FDIC argues that the portion of § 1823(e) that bars oral agreements "which tend[] to diminish or defeat the interest of the [FDIC] in any asset" is not incorporated in § 1821(d)(9)(A) because that portion of § 1823(e) is not one of "the *requirements* set forth in section 1823(e)." Opp. 19-20 (emphasis added). *Langley* holds precisely the opposite. *Langley* expressly holds that this portion of § 1823(e) is a "*requirement* of § 1823(e), namely, the *requirement* that the agreement in question 'ten[d] to diminish or defeat the right, title or interest' of the FDIC in the asset." 484 U.S. at 93 (emphasis added). It is astounding that, in its misguided attempt to defeat certiorari in this case, the FDIC raises an argument that expressly contradicts *Langley*.

b. Again, the government's purported alternative argument does not distinguish *Murphy*. The D.C. Circuit has twice held that section 1821(d)(9) " 'incorporates by reference the requirements of § 1823(e),' including the asset requirement, [*E.I.*] *du Pont* [*de Nemours & Co.* v. *FDIC*], 32 F.3d [592,] at 597 [(D.C. Cir. 1994)], and therefore can not provide an independent ground for judgment in favor of the FDIC." *Murphy*, 61 F.3d at 38. The FDIC concedes that its interpretation of § 1821(d)(9)(A) was rejected by *Murphy*. Opp. 20.

The Fifth Circuit has also held that "§ 1821(d)(9)(A) applies to the same type [of] agreements tied to 'acquisitions' of 'assets' as does § 1823(e)." *Thigpen* v. *Sparks*, 983 F.2d 644, 649 (5th Cir. 1993). *Thigpen* concluded that "absurd consequences would result" from the FDIC's position that § 1821(d)(9)(A) does not incorporate the specific asset requirement of § 1823(e):

> A claimant who furnished office supplies to the failed bank could not assert a claim unless his contract was (1) in writing, (2) executed by him and the bank contemporaneously with the sale of office supplies,

> (3) approved and recorded in the bank's board of directors' minutes and (4) continuously maintained as a bank record. . . . These results transform § 1821(d)(9)(A) . . . into a meat-axe for avoiding debts incurred in the ordinary course of business. *Id.*

The Seventh Circuit has also unequivocally rejected the FDIC's interpretation of § 1821(d)(9)(A). *John* v. *RTC*, 39 F.3d 773, 776 (7th Cir. 1994):

> [T]he only sensible reading of § 1821(d)(9)(A) must limit its scope to the loan-related transactions covered by § 1823(e). If "agreements" in § 1821(d)(9)(A) reached beyond the limitations of § 1823(e), the section would mean that, for example, trade creditors could only enforce agreements with the bank against the RTC if the bank's board of directors had approved and recorded the deals. . . . Such was surely not the intent of Congress.

c. In any event, the FDIC has conceded that § 1821(d)(9)(A) is not retroactive and thus cannot be applied to bar petitioners' claims. Opp. 15-17.

d. Even if the FDIC's § 1821(d)(9)(A) argument (i) was not expressly contradicted by *Langley* and (ii) was not conceded by the FDIC to be inapplicable to this case, it still would not provide any basis for denying certiorari and thus leaving the acknowledged *D'Oench* conflict in the circuit courts unresolved. The FDIC failed on a similar argument in *Langley* when it opposed certiorari on a circuit conflict involving interpretation of § 1823(e) by arguing that *D'Oench* provided an alternative ground for affirmance. FDIC Br. in Opp., *Langley* v. *FDIC*, No. 86-489, at 7 n.4, 8 n.5 (U.S. 1987). *O'Melveny* also addressed both federal common law and alternative statutory arguments raised by the FDIC. 114 S. Ct. at 2054-55. If the FDIC's approach to alternative arguments had been adopted by this Court, it would never have granted certiorari and decided the two leading cases in this area—*Langley* and *O'Melveny*.

## CONCLUSION

The petition for certiorari should be granted.

Respectfully submitted,

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